PROVINCE OF SASKATCHEWAN

10-11

ANNUAL REPORT

MINISTRY OF ENERGY AND RESOURCES

Oil and Gas Orphan Fund

Letters of Transmittal

July 2011

His Honour, the Honourable Dr. Gordon L. Barnhart
Lieutenant Governor
Province of Saskatchewan

May it please Your Honour:

I respectfully submit the Annual Report and Financial Statements of the Oil and Gas Orphan Fund for the fiscal year ending March 31, 2011.

Bill Boyd
Minister of Energy and Resources

July 2011

The Honourable Bill Boyd
Minister of Energy and Resources

Dear Sir:

I have the honour of submitting the Annual Report and Financial Statements of the Oil and Gas Orphan Fund for the fiscal year ending March 31, 2011.

Respectfully submitted,

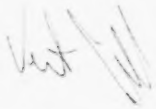
Kent Campbell
Deputy Minister
Energy and Resources

Management's Responsibility for Financial Statements

The accompanying financial statements included in the annual report of the Oil and Gas Orphan Fund for the year ended March 31, 2011, are the responsibility of the management of the Ministry of Energy and Resources. Management has prepared the financial statements in accordance with Canadian generally accepted accounting principles. The financial information presented elsewhere in the annual report is consistent with that in the financial statements.

To ensure the integrity and objectivity of the financial data, management maintains a comprehensive system of internal controls including written policies and procedures, and an organizational structure that segregates duties. These measures provide reasonable assurance that transactions are recorded and executed in compliance with legislation and required authority, that assets are properly safeguarded, and that reliable financial records are maintained.

The financial statements have been audited by the Office of the Provincial Auditor. Its report to the Members of the Legislative Assembly, stating the scope of its examination and opinion on the financial statements, appears on page four.



Kent Campbell
Deputy Minister
Energy and Resources

Regina, Saskatchewan
July 13, 2011

Introduction

The Oil and Gas Environmental Fund was established on May 17, 1989, pursuant to Section 18.2 of *The Oil and Gas Conservation Regulations, 1985* (Regulations). In June 2007, an amendment was made to *The Oil and Gas Conservation Act* that provided for the continuance of the existing Oil and Gas Environmental Fund as The Oil and Gas Orphan Fund.

The Oil and Gas Orphan Fund provides the government with a means to address the costs of abandoning and decommissioning orphan wells and facilities and reclaiming the sites as well as the costs of containing environmental emergencies arising from oil and gas operations.

The legislative authority for the fund and the specific provisions of the fund are found in *The Oil and Gas Conservation Act* and the regulations thereunder.

The fund is administered by the Saskatchewan Ministry of Energy and Resources.

Program Purpose

In 1989 Saskatchewan established The Oil and Gas Environmental Fund to provide a mechanism to abandon wells that had become orphaned and to allow the government to respond to a major spill or environmental problem where a responsible operator could not be identified. An orphan is a well (or facility) where the licensee and/or working interest participant(s) is/are insolvent or defunct. Legislative authority for the fund and specific provisions of the fund are found in *The Oil and Gas Conservation Act* and the regulations.

Based on the analysis by Energy and Resources officials, the potential liability presented by orphaned wells and facilities was significantly greater than the amount of money that had been available in The Oil and Gas Environmental Fund.

Currently in Saskatchewan there are potentially 700 orphaned oil and gas wells and facilities where the licensing company has ceased to exist or no longer can be located. The costs associated with proper abandonment, decommissioning and reclamation of these orphaned wells and facilities and the environmental liability associated with the sites are significant.

In order to address these problems, Energy and Resources staff were involved in exhaustive consultation with the oil and gas industry associations and other stakeholders over an eight-year period to develop the program and the legislation and regulations to support it. This extensive consultative process has led to the development of a comprehensive and robust set of regulations and a program that is fully funded and fully supported by the oil and gas industry.

Under the provisions of the program, each oil and gas company operating in Saskatchewan will pay into the Oil and Gas Orphan Fund through an annual levy.

The ministry will develop an annual budget and use monies from the fund to pay for the costs associated with abandoning, decommissioning and reclaiming wells, facilities and sites that have been orphaned.

Program Activities

During the 2010-11 fiscal year, the ministry invoiced its annual orphan fund levy of $1 million. The fund also had expenditures during the reporting period for well abandonment and reclamation of wells.

Independent Auditor's Report

To the Members of the Legislative Assembly of Saskatchewan

I have audited the accompanying financial statements of the Oil and Gas Orphan Fund, which comprise the statement of financial position as at March 31, 2011, and the statement of revenues, expenses and net financial assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards for Treasury Board's approval, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

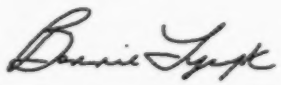
My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Oil and Gas Orphan Fund as at March 31, 2011, and the results of its operations, changes in its net financial assets, and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.



Bonnie Lysyk, MBA, CA
Provincial Auditor

Regina, Saskatchewan
July 13, 2011

Statement 1

Oil and Gas Orphan Fund
Statement of Financial Position
As at March 31

	2011	2010
Financial Assets		
Due from General Revenue Fund (Note 4)	$ 6,818,882	$ 5,464,320
Net Financial Assets (Statement 2) (Note 3)	$ 6,818,882	$ 5,464,320

(See accompanying notes to the financial statements)

Statement 2

Oil and Gas Orphan Fund
Statement of Revenues, Expenses and Net Financial Assets
For the Year Ended March 31

	Budget	Actual	
	2011	2011	2010
	(Note 6)		
Revenues:			
Fees (Note 2a, 5)	$ 90,000	$ 610,000	$ 410,000
Levies (Note 2b, 5)	1,915,000	990,573	1,036,818
Forfeited Security Deposits (Note 2c, 5)	—	—	—
Interest	90,000	52,585	13,488
Total Revenues	2,095,000	1,653,158	1,460,306
Expenses:			
Abandonment and Reclamation	2,000,000	298,596	40,033
Tender Costs	—	—	—
Advisory Committee	10,000	—	—
Returned Forfeited Security Deposits (Note 2d, 5)	—	—	—
Administration Costs	70,000	—	—
Total Expenses	2,080,000	298,596	40,033
Excess of revenues over expenses	$ 15,000	1,354,562	1,420,273
Net Financial Assets, beginning of year		5,464,320	4,044,047
Net Financial Assets, end of year – to Statement 1		$ 6,818,882	$ 5,464,320

(See accompanying notes to the financial statements)

Oil and Gas Orphan Fund
Notes to the Financial Statements
March 31, 2011

1. Authority

The Oil and Gas Environmental Fund (fund) was established on May 17, 1989, pursuant to Section 18.2 of *The Oil and Gas Conservation Regulations, 1985* (Regulations). The fund originated through a one-time assessment of $100 per well to a maximum of $20,000 per operator.

In June 2007, an amendment was made to the *Oil and Gas Conservation Act* that provided for the continuance of the existing Oil and Gas Environmental Fund as the Oil and Gas Orphan Fund (Order in Council #442/2007). The purpose of the fund is to address the issue of abandonment of wells, decommissioning of facilities, and clean-up of those wells and facilities where the obligations of the person responsible for carrying out those activities are not being met.

2. Significant Accounting Policies

Pursuant to standards established by the Public Sector Accounting Board, the fund is classified as an other government organization. These financial statements are prepared in accordance with Canadian generally accepted accounting principles applicable for the public sector. These financial statements do not present a statement of cash flows because this information is readily apparent from the statement of revenues, expenses and net financial assets.

a.) The fund recognizes the orphan fund fees as revenue when received with the accompanying first-time license application.

b.) The fund recognizes orphan fund levies as revenue when the levies are assessed.

c.) The fund recognizes security deposits as revenue when the Minister declares them forfeited to the Crown in the right of Saskatchewan.

d.) The fund recognizes any unused forfeited security deposits as an expense when the Minister approves their return to the depositor.

3. Net Financial Assets

The net financial assets represent assessments raised in accordance with subsection 18.3(2) of the Regulations less well site restoration costs. The net financial assets, together with any future recoveries of well site restoration costs, are available to provide for expenditures under section 18.4 of the Regulations related to the:

a.) abandonment of wells and restoration of abandoned well sites, as a result of disappearance or insolvency of the well owner or operator.

b.) containment or clean-up of major environmental problems arising from oil and gas exploration, development, production or transportation operations.

4. Related Party Transactions

Included in these financial statements are transactions with the government ministries and agencies related to the fund by virtue of common control by the Government of Saskatchewan.

The fund's money is on deposit with the General Revenue Fund (GRF). The GRF calculates and pays interest on a quarterly basis using the government's 30-day borrowing rate and the fund's average daily account balance. The government's average 30-day borrowing rate in 2010-11 was 0.80 per cent (2009-10 – 0.27 per cent).

The fund has not been charged with any administrative costs and no provision for such costs is reflected in these statements. These costs are borne by the Ministry of Energy and Resources.

5. Fees, Levies and Security Deposits

Section 10.3 of the Regulations requires all first-time applicants for a well or upstream facility licensee to pay a one-time fee of $10,000 which is deposited into the Oil and Gas Orphan Fund.

The primary purpose of the Saskatchewan Oil and Gas Orphan Fund is to prevent the occurrence of orphan wells and facilities in Saskatchewan. However, there are many wells and facilities that have previously been identified as orphans and others that are newly identified each year. These wells and facilities will require abandonment and the sites will require reclamation.

In order to pay for these costs, the Saskatchewan Orphan Fund Levy (the "orphan fund levy") was established. Each licensee in the province is levied, in accordance with the Regulations, on an annual basis to pay a percentage of a budget to carry out an annual orphan abandonment and reclamation program. Section 18.6(1) of the Regulations provides the details of how the levy is calculated for each licensee.

In addition, the Minister in accordance with the Act and Regulations may require irrevocable security deposits from holders of oil and gas licenses for the purpose of ensuring that they can meet their obligations with respect to suspension, abandonment, restoration, remediation, or reclamation of wells and upstream facilities and sites.

At March 31, 2011, the fund held $17,533,307 (2010 - $8,416,829) in security deposits from the holders of oil and gas licenses.

6. Budget

The budget for the fund is included with the Ministry of Energy and Resources' budget submission to Treasury Board. Treasury Board approves the fund's budget annually.